STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

I. MILES POLLACK : DETERMINATION DTA NO. 809622

for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law. : :

Petitioner, I. Miles Pollack, 925 Westchester Avenue, White Plains, New York 10604, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

On October 5, 1992 and October 14, 1992, respectively, petitioner appearing pro se and the Division of Taxation appearing by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel) consented to have the controversy determined on submission without hearing. On November 9, 1992 the Division of Taxation submitted documentary evidence. On December 17, 1992 petitioner submitted an affidavit with attachments supporting his position in lieu of a formal brief. On February 1, 1993 the Division of Taxation submitted a letter brief in support of its position. On March 1, 1993 petitioner submitted a letter in reply. After due consideration of the record, Timothy J. Alston, Administrative Law Judge, renders the following determination.

ISSUE

Whether the consideration received by petitioner in respect of his transfer of a controlling interest in an entity with an interest in real property properly included the apportioned mortgage debt on the underlying real property.

FINDINGS OF FACT

On or about September 15, 1984, 22 Leroy Owners Corp., a New York corporation, acquired title in fee to certain real property located at 22 Leroy Street, New York, New York.

The subject property at 22 Leroy Street was improved by an apartment building. The corporation's purchase price for the property was $600,000.00, paid as follows: i) $50,000.00 in cash, and ii) $550,000.00 in a purchase money wraparound mortgage and note.

Petitioner, along with Aaron Gelbwaks, Martin V. Herzog and Lizabeth Levkoff each owned an undivided 25 percent interest in the 212 shares of the corporation issued and outstanding. Petitioner and the other shareholders acquired their respective 25 percent interests at the time the corporation acquired title to the subject property in consideration of the acquisition costs.

Pursuant to an agreement dated July 29, 1987, petitioner agreed to sell his 25 percent interest in the corporation to Aaron Gelbwaks. The purchase price for petitioner's interest was $150,000.00, payable as follows: $25,000.00 in cash upon the signing of the July 29, 1987 agreement and $125,000.00 by a promissory note. The agreement provided that the promissory note was to be delivered to petitioner "on January 5, 1988, the closing date . . . ." The agreement further provided that the promissory note was to be "secured by a pledge, in escrow with Bernard J. Jaffe, Esq., of the shares of stock sold herein."

As part of the evidence submitted herein, petitioner submitted a copy of the promissory note referred to in the July 29, 1987 contract between petitioner and Aaron Gelbwaks. Said note was dated January 5, 1988 and provided in part:

> "This note shall be secured by a pledge of the shares of stock sold pursuant to Agreement between Gelbwaks and Pollack, dated July 29, 1987, with Bernard J. Jaffe, Esq., to be released under such conditions and at such times as set forth in said Agreement."

The pledge agreement referred to above was not entered into the record.

Pursuant to an agreement dated September 29, 1987 Martin Herzog and Lizabeth Levkoff agreed to sell their aggregate 50 percent interest in the shares of the corporation to Aaron Gelbwaks. The purchase price for this 50 percent interest was $550,000.00.

Petitioner was a party to the September 29, 1987 agreement which provided in part:

> "B. (1) The Sellers [Herzog and Levkoff], the Purchaser [Gelbwaks] and Pollack [petitioner] shall execute and deliver to Purchaser a Stock Power and Assignment of Proprietary Lease . . . so as to effect the transfer of record of the

Shares and Proprietary Lease to the Purchaser.

> "(2) The Sellers, the Purchaser and Pollack shall cause the Apartment Corporation to cancel the share certificate evidencing ownership of the Shares by the Sellers, the Purchaser and Pollack as tenants in common ('Old Share Certificate') and to issue a new share certificate in the name of the Purchaser . . . and to issue a Recognition Agreement and a Consent to the Assignment of the Shares to Purchaser . . . ."

Mr. Gelbwaks subsequently became the sole sponsor of a cooperative offering plan to convert the premises at 22 Leroy Street to cooperative ownership. A copy of the offering plan was entered into the record here. Page one of the offering plan states in part:

> "22 LEROY OWNERS CORP., acquired the fee interest in the Property at 22 Leroy Street, New York, New York on September 1, 1984 and issued all its outstanding shares to Martin V. Herzog, Lizabeth Levkoff, I. Miles Pollack and Aaron Gelbwaks in consideration of the acquisition costs. These individual sponsors submitted an Offering Plan ('red-herring') to the Department of Law on June 16, 1989. On September 29, 1987, AARON GELBWAKS became the sole stockholder of the corporation and sole Sponsor (the 'Sponsor') pursuant to written agreements by which he purchased all the interest held by Martin Herzog, Lizabeth Levkoff and I. Miles Pollack."

Page 74 of the offering plan states in part:

> "The property was acquired by 22 LEROY OWNERS CORP. on September 15, 1984. Aaron Gelbwaks, Martin V. Herzog, Lizabeth Levkoff and I. Miles Pollack, were the sole shareholders of 22 LEROY OWNERS CORP. The same individuals were the collective Sponsor who submitted a proposed Offering Plan to the Department of Law on June 18, 1986.
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> "On September 29, 1987 Mr. Gelbwaks became the sole shareholder of the Corporation and the sole principal Sponsor of this Offering Plan. The three former members of the Sponsor, Martin V. Herozg, Lizabeth Levkoff and I. Miles Pollack have no interest in the Offering Plan, wrap-around mortgage or the basement lease except in so far as evidenced by a security interest Note for a portion of the consideration paid to them. Such security interest shall be released as units are sold. No purchasers will be subject to any security interest or lien other than the wrap-around mortgage set forth in the Offering Plan."

No transferor or transferee questionnaires were filed with the Division of Taxation ("Division") in respect of the transfer from petitioner to Gelbwaks. Petitioner did not communicate with the Division with respect to this transfer until the Division initiated contact nearly two years after the transfer.

With respect to the purchase of the 22 Leroy Street property by the corporation on or about September 15, 1984, while the contract of sale indicates a mortgage in principal amount of $550,000.00, the closing statement indicates a principal mortgage amount of $549,993.75, which is the sum of the amounts of a "First Mortgage" ($96,093.75) and a "Purchase Money Mortgage" ($453,900.00). The contract of sale states that the wraparound mortgage was to be paid by payments of interest only for five years with a $50,000.00 principal payment required to be made three years from the date of the closing.

Upon its review of the transfer from petitioner to Gelbwaks, the Division determined that, for gains tax purposes, the mortgage debt in the subject real property should be added, pro rata, to the consideration received by petitioner in respect of the transfer. The Division determined that the transfer in question occurred on July 29, 1987. Pursuant to the terms of the Contract of Sale with respect to the corporation's September 15, 1984 acquisition of the property, the principal mortgage debt as of July 29, 1987 was $549,993.75. The Division allocated 25 percent of this indebtedness, or $137,498.44, to the consideration received by petitioner in respect of the subject transfer. The Division thus determined that the consideration received by petitioner in respect of the tax transfer totaled $287,498.44 ($150,000.00 per the July 29, 1987 contract of sale plus $137,498.44 of mortgage indebtedness). The Division allocated an original purchase price to petitioner's 25 percent interest in the corporation of $150,000.00, i.e., 25 percent of the $600,000.00 purchase price paid by the corporation to acquire the property. The Division thus determined a gain attributable to the subject transfer of $137,498.44. The Division further determined that such gain was subject to tax under Article 31-B of the Tax Law and on August 1, 1989 issued to petitioner a Notice of Determination which assessed $13,749.84 in gains tax due, in respect of the subject transfer plus penalty and interest.

It should be noted that the Division determined a total consideration for the 75 percent interest in the corporation acquired by Gelbwaks as follows:

Purchase Price for Pollack's 25% interest	$ 150,000.00
Mortgage Indebtedness Allocable to Pollack's 25% interest	137,498.44
Purchase Price for Herzog/Lavkoff's 50% interest	550,000.00
Mortgage Indebtedness Allocable to Herzog/Lavkoff's 50% interest	224,996.88
Total Consideration	$1,062,495.32

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax at a rate of 10 percent on gains derived from the "transfer of real property" within New York. Tax Law § 1440.7 defines "transfer of real property" to include a transfer or "acquisition of a controlling interest in any entity with an interest in real property." Tax Law § 1440.2(i) defines "controlling interest" in the case of a corporation as:

> "either fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the capital, profits or beneficial interest in such voting stock of such corporation . . . ."

Additionally, pursuant to 20 NYCRR 590.45(d) the acquisitions of interests in an entity with an interest in real property (acquired after March 28, 1983) are added together in determining whether an acquisition of a controlling interest has occurred.

B. Pursuant to the foregoing, the transfers of petitioner's 25 percent interest in the shares of the corporation and the transfer of the Herzog/Levkoff's 50 percent interest constituted an acquisition of a controlling interest by Gelbwaks. Accordingly, the gain derived from petitioner's transfer to Gelbwaks was properly subject to tax under Tax Law § 1441.

C. Tax Law § 1440.3 defines gain as:

> "[T]he difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

D. In a case involving a transfer of a controlling interest in an entity with an interest in real property, the original purchase price is the entity's original purchase price apportioned to the interest the transferor is transferring (20 NYCRR 590.49[a]; see also, Tax Law § 1440.5[g]).

Accordingly, the Division properly determined petitioner's original purchase price in his 25 percent interest to be $150,000.00, i.e., 25 percent of the corporation's original purchase price for the real property at issue of $600,000.00.

E. Tax Law § 1440(1)(a) provides that "consideration" includes the:

> "price paid or required to be paid . . . or any other thing of value and including the amount of any mortgage . . . whether the underlying indebtedness is assumed or

taken subject to."

F. Tax Law § 1440(1)(c) provides that, in the case of a transfer of a controlling interest in an entity with an interest in real property, in order to determine "consideration":

> "[T]here shall be an apportionment of the fair market value of the interest in real property to the controlling interest for the purpose of ascertaining the consideration for the transfer of such controlling interest."

G. 20 NYCRR 590.47 interprets Tax Law § 1440(1)(c) as follows:

> "(a) **Question**: Is the price paid for the ownership interest in an entity the consideration for a controlling interest used to calculate gain?
>
> "**Answer**: Generally, no . . . .
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> * * *
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> "Example: A corporation's only asset is a $4 million fair market value piece of property. If 100 percent of the stock is purchased, the consideration is $4 million ($4,000,000 x 100 percent). If a 50-percent interest were acquired, only $2 million consideration is used to calculate gain.
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> "(b) **Question**: How is fair market value determined?
>
> "**Answer**: Generally, by appraisal. It is the amount a willing buyer would pay a willing seller for the real property. It is not net fair market value, which deducts mortgages on the property from fair market value.
>
> "Thus, in the example in subdivision (a) of this section, if the property is encumbered by a $3 million mortgage, and $1 million is paid for 100 percent of the stock, the amount of consideration for the acquisition is $4 million, not $1 million."

H. Pursuant to the foregoing it is clear that the consideration received by petitioner in respect of his transfer of his 25 percent interest to Gelbwaks is properly determined by the fair market value of the subject property apportioned to the interest transferred (see, Matter of Goldome Capital Investments, Tax Appeals Tribunal, September 1, 1988).

I. In the instant matter the Division determined that, for gains tax purposes, the consideration received by petitioner in respect of the subject transfer included (in addition to the $150,000 contract price) the apportioned mortgage debt on the subject property. Upon review of the law and facts herein, it is clear that the Division's determination was proper. As noted "consideration" includes anything of value, including the amount of a mortgage (Tax Law § 1440[1][a]). As further noted, the value of the consideration in the instant matter must be determined by the fair market value of the subject real property. Accordingly, the Division's inclusion of the mortgage debt encumbering the property in the consideration received by petitioner in respect of the transfer clearly falls within the plain language of 20 NYCRR 590.47.

J. Petitioner contended that the Division's inclusion of the mortgage debt in the consideration received by him in respect of the subject transfer was improper. Specifically, petitioner contended that since he, as a shareholder, was not personally liable for the mortgage debt, then he derived no benefit of debt relief or forgiveness upon the subject transfer and that therefore, the amount of the debt should not be included in his consideration for the transfer. This contention is rejected. Since in an entity transaction the statute and regulations require that consideration be determined by reference to the underlying property's fair market value, the fact that petitioner was not personally liable for the mortgage is irrelevant. What is relevant is that the underlying property in the instant matter was encumbered by a mortgage debt and that petitioner sold his interest in the corporation for a certain price. It was clearly reasonable for the Division to determine that the consideration received by petitioner for his interest, i.e., the fair market value of petitioner's interest, consisted of the contract price for the shares plus the pro rata share of the mortgage debt encumbering the property. Indeed, the contract price plus the apportioned mortgage amount would appear to be the best evidence of fair market value available to the Division. Moreover, notwithstanding petitioner's contention that the contract price of the transfer was in excess of the fair market value of petitioner's interest, the record contains no evidence to support this claim.

K. Petitioner also contended that the Division erroneously determined the date of the subject transfer to be July 29, 1987, the date of the contract. Petitioner contended that the actual date of the transfer was January 5, 1988, referred to in the contract as the closing date. While the Contract of Sale indeed refers to January 5, 1988 as "the closing date", other documentation in the record indicates that the sale occurred prior to that date (see, Findings of Fact "7" and "8"). Accordingly, petitioner's contention must be deemed inconclusive and is therefore rejected.

L. Petitioner also contended that the total consideration attributable to the transactions involving petitioner and Herzog/Levkoff was less than $1,000,000.00 as a result of certain settlement negotiations in respect of the Herzog/Levkoff transaction. No evidence was presented in support of this contention and it is therefore rejected.

M. The petition of I. Miles Pollack is hereby denied and the Notice of Determination dated August 1, 1989 is sustained.

DATED: Troy, New York
July 8, 1993

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE